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DeNUCCI CITES CORRECTIVE ACTIONS AT LOTTERY IN RESPONSE TO PRIOR AUDITS

State Auditor Joe DeNucci reported in a follow-up audit today that the Massachusetts State Lottery has made improvements in response to several findings and recommendations in prior audits. However, DeNucci's audit includes several recommendations for further improvements in the operation of the Lottery.

According to DeNucci's audit, the Lottery has improved its internal controls over collections of revenue from sales agents. The report also noted that the Lottery has significantly reduced the instances of scanning of unsold tickets by sales agents. The Lottery now investigates all instances in which an agent has scanned eight or more losing tickets in a single day, an indication they could be looking for unsold winning tickets. The Lottery has also strengthened its agent licensing process and implemented an Agent Code of Conduct that strongly discourages agents and their employees from playing lottery games at their location.

DeNucci also reported that the Lottery is doing a better job of collecting accounts receivable owed by delinquent sales agents. A prior audit found that the Lottery had written off \$13 million in bad debt from fiscal years 1999 to 2002, but the follow-up audit noted that \$1.8 million was written off in fiscal 2003 and just \$700,000 in fiscal 2004. The total amount of receivables has decreased from \$1.4 million in fiscal 2003 to \$400,000 for the first six months of fiscal 2005.

However, DeNucci's audit found that the Lottery's internal audit function still needs improvements. Although a new Assistant Executive Director for Internal Audit/Compliance was named in 2003 and some reviews have been conducted over operating controls at regional offices and game closure procedures, there have been no audit reviews evaluating overall internal controls and risk identification in the Lottery's financial and program operations. In response, the Lottery indicated that its internal audit unit is working on a plan to identify and test risks.

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In another area, DeNucci reported that the Lottery should improve its oversight of its contracts with its three manufacturers of instant game tickets to ensure the integrity of the process as well as the continued flow of production. Because one vendor prints 80 percent of the instant rickets, a disaster at the production site could cripple the supply of tickets for this \$3 billion-per-year sales operation. The audit recommends that the Lottery develop a plan to test the adequacy of disaster recovery plans as well as the security systems and controls at manufacturing facilities.

In response, the Lottery agreed with DeNucci's contract monitoring recommendations and indicated it has contracted with all three of its ticket manufacturers to ensure the continued production of instant tickets in the event of a disaster, and is also maintaining a three-month supply of instant tickets.

The appearance of professional ticket cashing continues to be a problem at the Lottery, according to DeNucci's report. Although DeNucci's prior audits found numerous instances in which the same individuals repeatedly claimed hundreds of prizes worth millions of dollars, the latest review found that this practice has become even more widespread. In calendar year 2004, 88 individuals cashed 5,332 winning tickets totaling over \$10 million, while 71 persons cashed 4,527 winning tickets totaling \$8.2 million in 2003. This practice appears to be an attempt by ticket winners to circumvent federal and state tax obligations. Also, an investigation by DeNucci's Bureau of Special Investigations identified seven persons who inappropriately received \$174,000 in Medicaid assistance while collecting \$1,750,200 in lottery prizes.

Since DeNucci's last audit, state law has been amended to require the withholding of Massachusetts income tax on all winnings over \$600. Lottery officials also said they now provide a monthly report on suspected professional cashers to the Internal Revenue Service, Department of Revenue and Attorney General's Office. DeNucci said the Lottery should be more aggressive in its identification and reporting of suspicious ticket cashers.

"I want to commend Treasurer Cahill and the management of the Lottery for making a number of significant improvements in the Lottery's operation in response to recommendations in my previous audits," said DeNucci. "However, there is still more to be done to further protect this \$4 billion-a-year gaming operation and ensure integrity and accountability to the public and all of its players."